PARTICIPATION IN A BREACH OF TRUST

ANYONE who participates with a trustee in a breach of trust may be held liable in a court of equity to the *cestui que trust.* If he has received and still holds the trust property or its proceeds, he may be held as constructive trustee thereof; if he has never received or no longer holds the trust property or its proceeds, he may be held liable in equity for damages.

A purchaser of trust property is not liable merely because at the time of the purchase he knew of the existence of the trust attaching to the property. If the sale was not in fact in breach of trust, the purchaser takes the property free and clear of the trust. At common law, however, an extraordinary doctrine was widely accepted, to the effect that a purchaser of trust property is liable in equity to the *cestui que trust* for the purchase-price, although the trustee had made the sale in the proper exercise of a power of sale and although the purchaser had paid the purchase-money to the trustee, unless the money so paid was properly applied by the trustee for the purposes of the trust.[1] As Professor Ames has said,[2] "this highly artificial doctrine would seem to be indefensible on any principle." Why should the purchaser be responsible for a misapplication of the purchase-money by the trustee in which the purchaser did not participate and which he had no reason to anticipate? The courts have whittled away the rule by making many exceptions to it,[3] and in England and in many of the states it has been abolished by statute.[4] The effect of the rule is to ob-

[1] LEWIN, TRUSTS, 12 ed., pp. 534 *et seq.*; 2 PERRY, TRUSTS, 6 ed., §§ 790–799. The rule was applicable to mortgagees and pledgees as well as purchasers of trust property.

[2] AMES, CASES ON TRUSTS, 2 ed., 269 n.

[3] LEWIN, TRUSTS, 12 ed., pp. 535 *et seq.*; 2 PERRY, TRUSTS, 6 ed., §§ 790–799; 19 Am. St. Rep. 281.

[4] Law of Property Amendment Act, 1859 (22 & 23 Vict. c. 35), § 23; Lord Cranworth's Act (23 & 24 Vict. c. 145), § 29 (1860); Conveyancing and Law of Property Act, 1881 (44 & 45 Vict. c. 41), § 36; Trustee Act, 1893 (56 & 57 Vict. c. 53), § 20. The last named Act provides: "The receipt in writing of any trustee for any money, securities, or other personal property or effects payable, transferable, or deliverable to him under any trust or power shall be a sufficient discharge for the same, and shall

struct the proper administration of trusts by making it difficult for trustees to find persons who are willing to incur the risk attending the purchase of trust property. Where the rule prevails it is almost the universal custom to insert in a trust instrument containing a power of sale a provision that purchasers shall not be bound to see to the application of the purchase-money.

Except so far as a purchaser of trust property is bound to see to the application of the purchase-money, the general rule is well settled that a third person dealing with a known trustee is not liable to the *cestui que trust*, although the trustee in fact committed a breach of trust, unless the third person knew or ought to have known that the trustee was committing or intending to commit a breach of trust. He is not chargeable with participation in a breach of trust merely because he knew or ought to have known of the existence of the trust; it must appear also that he knew or ought to have known that the trustee was committing or contemplating the commission of a breach of trust.[5]

It is easy to affix liability upon one who obtains trust property from a trustee with actual knowledge of the existence of the trust and of the fact that the trustee is committing a breach of trust. No principle in the law of trusts is more clearly settled than that a transferee of trust property who knows that the transfer is in breach of trust is liable to the *cestui que trust*.[6] It was settled law as to uses as far back as 1465.[7] Similarly a purchaser of trust

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effectually exonerate the person paying, transferring, or delivering the same from seeing to the application or being answerable for any loss or misapplication thereof."

A number of the American statutes are cited in 2 Perry, Trusts, 6 ed., § 790. One of the most recent statutes is Mass. L. 1918, c. 68, § 2. New York Real Property Law, § 108, provides: "A person who shall actually and in good faith pay a sum of money to a trustee, which the trustee as such is authorized to receive, shall not be responsible for the proper application of the money, according to the trust; and any right or title derived by him from the trustee in consideration of the payments shall not be impeached or called in question in consequence of a misapplication by the trustee of the money paid."

[5] "A stranger to the trust receiving money from the trustee which he knows to be part of the trust estate is not liable as a constructive trustee unless there are facts brought home to him which shew that to his knowledge the money is being applied in a manner which is inconsistent with the trust; or (in other words) unless it be made out that he is party either to a fraud, or to a breach of trust on the part of the trustee." *Re* Blundell, 40 Ch. D. 370, 381 (1888), per Stirling, J.

[6] See Scott, Cases on Trusts, c. VII.

[7] Y. B. 5 Ed. IV., fol. 7, pl. 16; Scott, Cases on Trusts, 688. See also Y. B. 11 Ed. IV., fol. 8 (1471), cited 3 Maitland, Collected Papers, 345.

property is liable if he pays the purchase-price to the trustee with knowledge that the trustee intends to misapply the money so paid.[8] Similarly, if a *chose* in action is held by the obligee in trust, the obligor is liable if, knowing of the trust, he accepts a release in consideration of the cancellation of a personal indebtedness of the obligee to him.[9] So also the obligor is liable if he pays the obligee-trustee, with knowledge that the latter intends to misappropriate the money.[10] *A fortiori* an obligor is precluded from setting off a personal debt of the obligee to him, if he knows that the obligee's claim against him is held in trust.[11]

But suppose that a purchaser of trust property has no actual knowledge that the vendor is committing or contemplating the commission of a breach of trust. When and to what extent ought he make inquiry, ought he investigate, in order to ascertain whether or not the vendor is acting in breach of trust? Of course, strictly speaking, there is no "duty" to make any inquiry. But the circumstances may be such that the purchaser cannot escape liability if an inquiry or investigation would disclose the vendor's breach of trust.[12]

If one takes a conveyance as purchaser or mortgagee from a person whose name in the document of title is followed by the word "trustee" or other words indicating a fiduciary character, he

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In Georgia it is expressly provided by statute that "All persons aiding and assisting trustees of any character, with a knowledge of their misconduct, in misapplying assets, are directly accountable to the persons injured." 3 PARK'S ANN. CODE, GA. (1914), § 3784.

[8] M'Leod *v.* Drummond, 17 Ves. 152 (1810) (executor); Tillinghast *v.* Champlin, 4 R. I. 173, 209 (1856) (partner). See Manhattan Bank *v.* Walker, 130 U. S. 267, 279 (1889). *Cf.* Tapley *v.* Tapley, 115 Ga. 109, 41 S. E. 235 (1902) (subsequent collusion in misapplication of purchase-price held not to affect validity of sale).

[9] SCOTT, CASES ON TRUSTS, 646 n. See notes 14, 15, 24 and 66, *infra.*

[10] Taylor *v.* Harris' Adm'r, 164 Ky. 654, 176 S. W. 168 (1915) (guardian).

[11] AMES, CASES ON TRUSTS, 270 n; SCOTT, CASES ON TRUSTS, 647 n, 739 n. See note 65, *infra.*

[12] The English Conveyancing Act, 1882 (45 & 46 Vict. c. 39), § 3 provides that a purchaser shall not be prejudicially affected by notice of any instrument, fact, or thing unless it is within his own (or his agent's) knowledge, or "would have come to his knowledge if such inquiries and inspections had been made as ought reasonably to have been made." In Bailey *v.* Barnes, [1894] 1 Ch. 25, 35, it is explained that the word "ought" does not import a duty or obligation, and that the expression "ought reasonably" means "ought as a matter of prudence, having regard to what is usually done by men of business under similar circumstances."

is chargeable with notice of the existence of a trust; [13] and if he actually knows that the transferor is making a conveyance in payment of or as security for his individual indebtedness, the transferee is liable to the *cestui que trust*, unless upon a reasonable inquiry it would appear that the transferor was not violating his duty as trustee.[14] The result is the same whenever the circumstances are such as to inform the transferee that the transferor is a fiduciary and is making the conveyance for his own personal advantage.[15] It is of course possible that there was in reality no trust, or the trust may have been of such a character that the transferor was not acting improperly in making the transfer, or the beneficiary may have authorized the transfer. But the transaction is *prima facie* wrongful, and the transferee should make

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[13] By the great weight of authority such words are not treated as mere *descriptio personæ* and of no effect. In the leading case of Shaw *v.* Spencer, 100 Mass. 382, 393 (1868), Foster, J., said: "The fact that it is common to issue certificates of stock in the name of one as trustee, when no trust actually exists, has no legal bearing on the decision of the present case. The rules of law are presumed to be known by all men; and they must govern themselves accordingly. The law holds that the insertion of the word 'trustee' after the name of a stockholder does indicate and give notice of a trust. No one is at liberty to disregard such notice and to abstain from inquiry for the reason that a trust is frequently simulated or pretended when it really does not exist. The whole force of this offer of evidence is addressed to the question whether the word 'trustee' alone has any significance and does amount to notice of the existence of a trust."

[14] Scott *v.* Tyler, 2 Dick. 712, 724 (1788) (executor); Hill *v.* Simpson, 7 Ves. 152 (1802) (executor); M'Leod *v.* Drummond, 14 Ves. 353, 358 (1807), 17 Ves. 152, 172 (1810) (executor); Johnson *v.* Amberson, 140 Ala. 342, 37 So. 273 (1903) (trustee); Cohen *v.* Parish, 105 Ga. 339, 31 S. E. 205 (1898) (trustee); Hill *v.* Fleming, 128 Ky. 201, 107 S. W. 764 (1908) (public officer); Shaw *v.* Spencer, 100 Mass. 382 (1868) (trustee); Smith *v.* Burgess, 133 Mass. 511 (1882) (trustee); Galloway *v.* Gleason, 61 Mo. App. 21 (1895) (trustee); Wisconsin Yearly Meeting *v.* Babler, 115 Wis. 289, 91 N. W. 678 (1902) (treasurer). See LEWIN, TRUSTS, 12 ed., 562; PERRY, TRUSTS, 6 ed., §§ 225, 814. See notes 24, 25 and 26, *infra*.

[15] As where the property is pledged by the trustee to secure a present loan which is apparently a loan to the trustee personally. Bank of Montreal *v.* Sweeny, 12 App. Cas. 617 (1887); Keane *v.* Robarts, 4 Madd. 332, 357 (1819) (*semble*); Duncan *v.* Jaudon, 15 Wall. (U. S.) 165 (1872); Henshaw *v.* State Bank, 239 Ill. 515, 88 N. E. 214 (1909); Clemens *v.* Heckscher, 185 Pa. 476, 40 Atl. 80 (1898). *Cf.* Taylor *v.* Harris' Adm'r, 164 Ky. 654, 176 S. W. 168 (1915).

"If there are circumstances that would arouse the suspicion of a reasonable man, inquiry must be made until a reasonable man would be satisfied; and if inquiry be not made, the person charged cannot take advantage of his own wrong, but is held to have notice of everything that a proper inquiry would have revealed." LOWELL, TRANSFER OF STOCK, § 67.

inquiry, and is chargeable with notice of everything that upon a reasonable inquiry would appear.

But suppose that the transferee does not know that the transferor is making a conveyance for his own personal advantage, and has no more reason to think that the transfer is wrongful than that it is rightful. Is the transferee bound to make inquiry as to the authority of the transferor to make the transfer? The courts have usually answered this question in the affirmative. One who purchases or lends money on the security of property which he knows to be trust property should inquire whether the trustee is empowered to sell or mortgage it.[16] If the trustee's authority is evidenced by a will or other instrument in writing of which the transferee knows, he has failed to make a reasonable inquiry if he has not examined the instrument; and he is liable if the instrument shows that the trustee was exceeding his authority in making the transfer.[17] And if the instrument shows that the transfer is authorized only if, for example, one of the beneficiaries gives a written consent to the transfer, he should ascertain whether such

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[16] Stroughill *v.* Anstey, 1 DeG., M. & G. 635 (1852) (trustee); Sternfels *v.* Watson, 139 Fed. (C. C. Ore.) 505 (1905) (T, holding land "as trustee," makes unauthorized mortgage; subsequent purchaser bound to inquire into authority of T to mortgage); Tuttle *v.* First Nat. Bank, 187 Mass. 533, 73 N. E. 560 (1905) (pledge by trustee of stock); Donnelly *v.* Alden, 229 Mass. 109, 118 N. E. 298 (1918) (mortgage of land by executor improperly carrying on testator's business); Snyder *v.* Collier, 85 Neb. 552, 123 N. W. 1023 (1909) (trustee of land); Gaston *v.* American Exch. Nat. Bank, 29 N. J. Eq. 98 (1878) (T, holding stock "as trustee," makes unauthorized pledge); Suarez *v.* de Montigny, 1 App. Div. 494, 37 N. Y. Supp. 503 (1896), affirmed 153 N. Y. 678, 48 N. E. 1107 (1897) (trustee of mortgage); First National Bank *v.* National Broadway Bank, 156 N. Y. 459, 51 N. E. 398 (1898) (trustee of stock); Ludington *v.* Mercantile National Bank, 102 App. Div. 251, 92 N. Y. Supp. 454 (1905) (trustee of stock); McLeod *v.* Despain, 49 Ore. 536, 90 Pac. 492, 92 Pac. 1088 (1907) (trustee); Kenworthy *v.* Equitable Trust Co., 218 Pa. 286, 67 Atl. 469 (1907) (trustee of mortgage); Freeman *v.* Bailey, 50 S. C. 241, 27 S. E. 686 (1897) (trustee of overdue note). See note 28, *infra*.

But see Northwestern, etc. Co. *v.* Atlantic Co., 174 Cal. 308, 163 Pac. 47 (1917) (holding the word "trustee" not enough to put the purchaser upon inquiry); Salisbury Mills *v.* Townsend, 109 Mass. 115 (1871) (holding that a purchaser of stock need not ascertain validity of previous assignments).

[17] Donnelly *v.* Alden, 229 Mass. 109, 118 N. E. 298 (1918); Suarez *v.* de Montigny, 1 App. Div. 494, 37 N. Y. Supp. 503 (1896), affirmed 153 N. Y. 678, 48 N. E. 1107 (1897); First National Bank *v.* National Broadway Bank, 156 N. Y. 459, 51 N. E. 398 (1898); Ludington *v.* Mercantile National Bank, 102 App. Div. 251, 92 N. Y. Supp. 454 (1905); Kenworthy *v.* Equitable Trust Co., 218 Pa. 286, 67 Atl. 469 (1907). See 2 PERRY, TRUSTS, 6 ed., p. 1313 n.

consent has been given.[18] If there is no such instrument of which the transferee knows, he should make such inquiry as to the authority of the transferor as a reasonable man would make under the circumstances. If a reasonable inquiry shows that the transferor has apparently authority to make the sale or mortgage, and there is nothing in the nature of the transaction to indicate a breach of trust, the transferee is not bound to inquire further. He need not ascertain whether there are circumstances which may make the transfer improper, or whether the trustee is exercising a sound discretion or whether his motives in making the transfer are proper, nor need he inquire into the intended application of the proceeds.[19]

How far are these principles applicable to negotiable instruments? The mere fact that the name of a payee of a negotiable instrument is followed by the word "trustee" or other words indicating a fiduciary character, does not render the instrument nonnegotiable.[20] But if the purchaser of such an instrument is bound

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[18] Suarez *v.* de Montigny, 1 App. Div. 494, 37 N. Y. Supp. 503 (1896) (affirmed 153 N. Y. 678, 48 N. E. 1107 (1897)).

[19] See Grafflin *v.* Robb, 84 Md. 451, 35 Atl. 971 (1896); Kirsch *v.* Tozier, 143 N. Y. 390, 396, 38 N. E. 375 (1894); Spencer *v.* Weber, 163 N. Y. 493, 57 N. E. 753 (1900); PERRY, TRUSTS, 6 ed., §§ 225, 814; 1 COOK, CORPORATIONS, 7 ed., § 326; LOWELL, TRANSFER OF STOCK, §§ 67–79; 14 CORP. JUR. 785.

Since it is the duty of an executor to reduce the estate to money so far as is necessary to enable him to pay debts and pecuniary legacies, the purchaser may assume that the executor has power to sell, and need not inquire whether the sale is actually necessary for the payment of debts or otherwise, where statutes do not require a court order to authorize a sale. Ewer *v.* Corbet, 2 P. Wms. 148 (1723); Keane *v.* Robarts, 4 Madd. 332, 356 (1819); Fletcher *v.* American Trust & B. Co., 111 Ga. 300, 36 S. E. 767 (1900); Prall *v.* Tilt, 28 N. J. Eq. 479 (1877); Wood's Appeal, 92 Pa. 379 (1880); WARREN, CASES ON WILLS, 611–626; PERRY, TRUSTS, 6 ed., §§ 225, 809. This is true also of guardians, where statutes do not require a court order. Fountain *v.* Anderson, 33 Ga. 372 (1862); Field *v.* Schieffelin, 7 Johns. Ch. (N. Y.) 150 (1823). On the other hand since a trustee is not in general empowered to sell trust property unless expressly or by implication authorized by the instrument creating the trust or, by an order of court, a purchaser should ascertain whether a power of sale is to be found in the instrument. PERRY, TRUSTS, 6 ed., § 814. In some jurisdictions by statute power to change investments and to make sales is conferred upon trustees in the absence of any provision by the settlor to the contrary. See MASS. LAWS, 1918, c. 68, § 1. See also Trustee Act, 1893 (56 & 57 Vict. c. 53), § 1.

[20] Walter *v.* Kirk, 14 Ill. 55 (1852) (administrator); Central State Bank *v.* Spurlin, 111 Iowa 187, 82 N. W. 493 (1900) (trustee); Downer *v.* Read, 17 Minn. 493 (1871) (trustee); Bank *v.* Looney, 99 Tenn. 278, 42 S. W. 149 (1897) (trustee); Dollar Sav. & T. Co. *v.* Crawford, 69 W. Va. 109, 70 S. E. 1089 (1911) (trustee). See 8 CORP. JUR. 174. But see Hazeltine *v.* Keenan, 54 W. Va. 600, 46 S. E. 609 (1904) (attorney).

to make an investigation as to the authority of the holder to negotiate the instrument, and to ascertain whether he has exceeded his authority, its marketability will be much impaired. It is provided in the Uniform Negotiable Instruments Law, section 56, that:

"To constitute notice of an infirmity in the instrument or defect [21] in the title of the person negotiating the same, the person to whom it is negotiated must have had actual knowledge of the infirmity or defect, or knowledge of such facts that his action in taking the instrument amounted to bad faith."

Of course an indorsee of negotiable paper payable to a fiduciary is not a *bona fide* purchaser if he actually knows that the holder is acting wrongfully in negotiating it, or if he suspects that the lender is acting wrongfully and refrains from making an inquiry in order to avoid obtaining such actual knowledge. But does the mere fact that the fiduciary character of the holder appears on the face of the instrument preclude the indorsee from asserting that he is a holder in due course, if he has failed to make any inquiry as to the right of the holder to negotiate it? [22]

If the name of the holder of a negotiable instrument is followed by the word "trustee" or other words indicating a fiduciary character, and it is transferred by him in payment of a private debt,[23] it is held that the purchaser is bound to make inquiry as to the propriety of the holder's conduct. The transaction is *prima facie* wrongful. This applies when the holder is designated as a trustee, executor, administrator, guardian, agent, or the like,[24] and also

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[21] "The title of a person who negotiates an instrument is defective within the meaning of this act . . . when he negotiates it in breach of faith, or under such circumstances as amount to a fraud." N. I. L., § 55.

[22] It is agreed that under the Negotiable Instruments Law, and according to the weight of authority at common law, a holder is not denied protection merely because he is negligent. EATON AND GILBERT, COMMERCIAL PAPER, § 75; 8 CORP. JUR. 499-507.

[23] If a trustee incurs a debt in the administration of a trust, the creditor in receiving payment out of the trust fund, as he knows, is not bound to inquire into the state of the trustee's accounts in order to ascertain whether the trustee has lost his right of indemnity. *Re* Blundell, 40 Ch. D. 370 (1888).

[24] Manhattan Bank *v.* Walker, 130 U. S. 267 (1888) (agent); McBain *v.* Seligman, 58 Mich. 294, 25 N. W. 197 (1885) (agent); Payne *v.* First Nat. Bank, 43 Mo. App. 377 (1891) (trustee); Atlantic State Bank *v.* Savery, 82 N. Y. 291 (1880) (partner) (*semble*); Brovan *v.* Kyle, 160 Wis. 347, 165 N. W. 382 (1917) (guardian). But see

when the instrument is payable to a corporation and is indorsed by an officer of the corporation and transferred by him in payment of his private debt.[25] The principle is likewise applicable when an instrument is drawn by one as fiduciary whether as trustee, executor, administrator, guardian or the like, or by a public official or corporate officer, payable to his private creditor, or by the weight of authority when payable to bearer or to himself personally and delivered in payment of his private debt.[26] The result is the

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Fletcher *v.* Schaumburg, 41 Mo. 502, 506 (1867) ("Shff."); Mayer *v.* Bank, 86 Mo. App. 108 (1900) (curator, *semble*). See 1 DANIEL, NEGOTIABLE INSTRUMENTS, 6 ed., §§ 271, 795 a. See note 66, *infra*.

The opposite result was reached in First Denton Nat. Bank *v.* Kenney, 116 Md. 24, 81 Atl. 227 (1911), where the holder's name was followed by the word "attorney." *Cf.* Cunningham *v.* Bank, 13 Ida. 167, 88 Pac. 975 (1907) (attachment). But see Hazeltine *v.* Keenan, 54 W. Va. 600, 46 S. E. 609 (1904).

[25] Palo Alto, etc. Assn. *v.* First Nat. Bank, 33 Cal. App. 214, 164 Pac. 1124 (1917); Norment *v.* First Nat. Bank, 23 N. Mex. 198, 167 Pac. 731 (1917) (*semble*); Ward *v.* City Trust Co., 192 N. Y. 61, 84 N. E. 585 (1908); Cheever *v.* Pittsburgh, etc. R. R. Co., 72 Hun (N. Y.) 380, 25 N. Y. Supp. 449 (1893); Jenkins *v.* Planters' & Mechanics' Bank, 34 Okl. 607, 126 Pac. 757 (1912); Pelton *v.* Spider Lake, etc. Co., 132 Wis. 219, 112 N. W. 29 (1907). See 1 DANIEL, NEGOTIABLE INSTRUMENTS, 6 ed., § 795 c.

[26] Lamson *v.* Beard, 94 Fed. (C. C. A. 7) 30 (1899) (corporate officer); Redfield *v.* Wells, 31 Ida. 415, 173 Pac. 640 (1918) (partner, payable to creditor, discussion of effect of N. I. L.); Leigh *v.* American Brake-Beam Co., 205 Ill. 147, 68 N. E. 713 (1903) (corporate officer); Washbon *v.* Hixon, 87 Kan. 310, 124 Pac. 366 (1912) (treasurer of fraternal organization); Hill *v.* Fleming, 128 Ky. 201, 107 S. W. 764 (1908) (public officer); Newburyport *v.* Fidelity Ins. Co., 197 Mass. 596, 84 N. E. 111 (1908) (city treasurer); Newburyport *v.* Spear, 204 Mass. 146, 90 N. E. 522 (1910) (city treasurer, payable to self); Coleman *v.* Stocke, 159 Mo. App. 43, 139 S. W. 216 (1911) (corporate officer, payable to cash); McCullam *v.* Buckingham Hotel Co., 198 Mo. App. 107, 199 S. W. 417 (1917) (corporate officer, payable to creditor); McCullam *v.* Mermod, etc. Co., 218 S. W. (Mo. App.) 345 (1920) (corporate officer, payable to self); Gerard *v.* McCormick, 130 N. Y. 261, 29 N. E. 115 (1891) (agent); Rochester, etc. Ry. Co. *v.* Paviour, 164 N. Y. 281, 58 N. E. 114 (1900) (corporate officer); Cohnfeld *v.* Tanenbaum, 176 N. Y. 126, 68 N. E. 141 (1903) (guardian); Squire *v.* Ordemann, 194 N. Y. 394, 87 N. E. 435 (1909) (executor); Lanning *v.* Trust Co. of America, 137 App. Div. 722, 122 N. Y. Supp. 485 (1910) (corporate officer); Surety Co. *v.* Nelson, 141 App. Div. 850, 126 N. Y. Supp. 453 (1910) (special guardian); Newman *v.* Newman, 160 App. Div. 331, 145 N. Y. Supp. 325 (1914) (corporate officer, payable to self); First Nat. Bank *v.* Gillette, 52 Okl. 341, 152 Pac. 1084 (1915) (corporate officer, payable to creditor); Schmitt *v.* Potter T. & T. Co., 61 Pa. Sup. Ct. 301 (1915) (corporate officer); Sheer *v.* Hall & Lyon Co., 36 R. I. 47, 88 Atl. 801 (1913) (corporate officer, payable to creditor); Clement Nat. Bank *v.* Connolly, 88 Vt. 55, 90 Atl. 794 (1914) (partner).

But see Fillebrown *v.* Hayward, 190 Mass. 472, 77 N. E. 45 (1906) (corporate officer, payable to self); Goshen Nat. Bank *v.* State, 141 N. Y. 379, 36 N. E. 316 (1894) (cashier's draft payable to cashier's private creditor). See 8 CORP. JUR. 515, 521, 522.

same whenever the circumstances are such as to make it evident that the transaction is for the personal benefit of the fiduciary.[27]

It is of course possible that the fiduciary is authorized to make payment to himself personally out of his principal's funds, as where the principal is indebted to him for salary, commissions, dividends, reimbursement for expenses or the like. The fiduciary may even be authorized by his principal to draw checks payable to his private creditor. Watts *v.* Gordon, 127 Tenn. 96, 153 S. W. 483 (1912). The courts almost universally hold, however, as shown by the above cases, that the transaction is *prima facie* improper and that the creditor is put upon inquiry.

The creditor is not put upon inquiry where the payee of a corporate note is a director of the corporation. Orr *v.* South Amboy, etc. Co., 113 App. Div. 103, 98 N. Y. Supp. 1026 (1906). *Cf.* Pemiscot County Bank *v.* Central-State Nat. Bank, 132 Tenn. 152, 177 S. W. 74 (1915).

The mere fact that the instrument is signed by another officer as well as the fiduciary does not dispense with the necessity of making inquiry. Newman *v.* Newman, 160 App. Div. 331, 145 N. Y. Supp. 325 (1914), *supra*. But *cf. Re* Troy & Cohoes Shirt Co., 136 Fed. (D. C., N. D., N. Y.) 420 (1905), affirmed 142 Fed. 1038 (1906).

But if one as a fiduciary draws an instrument payable to a third person who indorses to the fiduciary personally, a subsequent purchaser is not bound to make inquiry. Cheever *v.* Pittsburgh, etc. R. R. Co., 150 N. Y. 59, 44 N. E. 701 (1896). *Cf.* National City Bank *v.* Shelton Electric Co., 96 Wash. 74, 164 Pac. 933 (1917).

In Fillebrown *v.* Hayward, 190 Mass. 472, 77 N. E. 45 (1906), it was held that where checks of a corporation signed by its treasurer payable to himself individually were indorsed by him in payment of his private debt, the indorsee was not put upon inquiry and was a *bona fide* purchaser, since it was not shown that the indorsee knew that the indorser was acting fraudulently nor that she deliberately decided to refrain from making inquiries; she either gave no thought to the matter or "may have inferred that the money so appropriated was in payment of his [the treasurer's] own salary, or otherwise was being withdrawn lawfully." This case was explained in Johnson & Kettell Co. *v.* Longley Luncheon Co., 207 Mass. 52, 56, 92 N. E. 1035 (1910), by Loring, J., who said: "The distinction seems to be this: Where the corporation note or other negotiable instrument is payable to the creditor of the individual, the transaction which on the face of the note or other instrument is represented to have taken place is an appropriation of the corporation's money to the payment of the individual's debts and is bad unless shown to be good. Since the transaction is bad unless shown to be good and since the purchaser took with notice (given on the face of the note or other instrument), his rights depend upon the transaction's being or not being in fact what it purports on the face of the note or instrument to be, and no question of a purchase in good faith can arise. . . . But on the other hand where the note or other instrument is payable to the treasurer or to a third person and after being indorsed by

[27] See Thornton *v.* Netherlands, etc. Co., 178 App. Div. 604, 165 N. Y. Supp. 682 (1917), where the treasurer of a corporation paid the defendant steamship company for a passage ticket by a check of the corporation drawn by himself as treasurer, and payable to himself. *Cf.* Mayor *v.* Sands, 39 Hun (N. Y.) 519 (1886). But see Cluett *v.* Couture, 140 App. Div. 830, 125 N. Y. Supp. 813 (1910), where a manager of the plaintiff firm, who had authority to indorse checks and deposit them in a bank, indorsed a check and delivered it to the defendant in payment of a hotel bill, receiving the balance in cash.

But suppose that the instrument is not used for the purpose of paying a private debt of the fiduciary. Is the indorsee or payee under an obligation to ascertain whether the indorser or drawer is committing a breach of his fiduciary obligation? To impose such an obligation seriously impairs the marketability of such instruments. It seems to deprive the indorsee or payee of the defense of purchase for value although he has no actual knowledge of the defect and does not act in bad faith. By the weight of authority nevertheless the indorsee or payee is bound to make inquiry as to the authority of the indorser or drawer to indorse or draw.[28] But in the absence of any circumstance in the transaction indicating a breach of trust, he is not bound to inquire further into the propriety of the transaction.[29]

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the payee in blank is used by the treasurer in paying his individual debt, the transaction which on the face of the instrument is represented to have taken place is a payment by the corporation to the treasurer (where the note or other instrument was payable to him), and a payment by the corporation to the third person and another payment by the third person to the treasurer (where the note or other instrument was payable to a third person as stated above). In each of these last two cases the transaction on its face is good unless it is proved to be bad. In that case, if the corporation proves that the application of the note or other instrument of the corporation was a wrongful one, the rights of the creditor depend upon his having acted in good faith." But see Newman *v.* Newman, 160 App. Div. 331, 145 N. Y. Supp. 325 (1914), *supra.*

In Missouri a statute (Laws 1917, 144) provides: "If any check, draft or order of any corporation, firm or copartnership shall be given in payment of the debt of any officer, agent or employee, of said corporation, firm or copartnership, the payee or other person collecting such check, draft or order shall not be liable to said corporation, firm or copartnership therefor, unless it shall be shown that such payee or other person, at the time of collecting same, had actual knowledge that said check, draft or order was issued without authority of said corporation, firm or copartnership."

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[28] McMasters *v.* Dunbar, 2 La. Ann. 577 (1847) (tutor); Nicholson *v.* Jacobs, 2 La. Ann. 666 (1847) (syndic); Third National Bank *v.* Lange, 51 Md. 138 (1878) (trustee); Ford *v.* Brown, 114 Tenn. 467, 88 S. W. 1036 (1904) (trustee, holding that the Negotiable Instruments Law does not protect subsequent purchasers since the defect appeared on the face of the instrument); Dollar Sav. & T. Co. *v.* Crawford, 69 W. Va. 109, 70 S. E. 1089 (1911) (trustee, *semble*). See 1 DANIEL, NEGOTIABLE INSTRUMENTS, 6 ed., §§ 271, 795 a, 795 c; PERRY, TRUSTS, 6 ed., §§ 225, 814.

In some states it is held that the payee of a negotiable instrument cannot be a holder in due course; but the better view and the weight of authority are otherwise. Redfield *v.* Wells, 31 Ida. 415, 173 Pac. 640 (1918). See BRANNAN, THE NEGOTIABLE INSTRUMENTS LAW, 3 ed., 162, commenting on N. I. L., § 52.

[29] Ashton *v.* Atlantic Bank, 3 Allen (Mass.) 217 (1861) (trustee); Norman *v.* Towne, 130 Mass. 52 (1880) (trustee); Mason *v.* Bank of Commerce, 16 Mo. App. 275 (1884) (trustee); Weeks *v.* Fox, 3 Thom. & C. (N. Y.) 354 (1874) (agent). See 1 DANIEL,

Such being the general rules as to purchasers of trust property, including those who take a security interest, the question arises whether these rules are applicable to persons who are not purchasers but who in other capacities deal with trustees in respect to the trust property.

In England it is held that a person who does not himself receive any part of the trust property and who in no way profits by a breach of trust is not liable for participation therein merely because he has in some way aided in the commission of the breach of trust, even though he knows or might have known of the breach of trust. In *Re Barney* [30] a testator who had been carrying on business left his property to his widow upon trust for herself and his children, but gave no directions as to the carrying on of his business. The widow decided to carry on the business. The defendants, two of her friends, who were aware that the carrying on of the business would be a breach of trust, agreed to assist her by advice and by supervising her conduct of the business. Among other things it was agreed that they should initial all checks drawn by her as trustee, and the bank in which deposits were made by her was directed to honor such checks only as were so initialed. The defendants never had possession of any of the trust property. It was held that they were not liable for participation in the breach of trust. Similarly it has been held [31] that the solicitor of a trustee who had advised against a delegation of the trust was not liable for a participation in the misconduct of the trustee in making such delegation, merely because he had prepared the instruments whereby the trustee effected the delegation, although the new trustee misappropriated the trust property, since the solicitor had no knowledge of or reason to suspect a dishonest design of the old or of the new trustee in the transaction.[32] On the other hand, if the defendant

NEGOTIABLE INSTRUMENTS, 6 ed., §§ 271, 795 a, 795 c; EATON AND GILBERT, COMMERCIAL PAPER, § 75; PERRY, TRUSTS, 6 ed., §§ 225, 814. See note 19, *supra*. But see Third National Bank *v.* Lange, 51 Md. 138 (1878) (trustee); Strong *v.* Straus, 40 Ohio St. 87 (1883) (guardian); Ford *v.* Brown, 114 Tenn. 467, 88 S. W. 1036 (1904) (trustee).

[30] [1892] 2 Ch. 265.

[31] Barnes *v.* Addy, L. R. 9 Ch. 244 (1874).

[32] See also Mara *v.* Browne, [1896] 1 Ch. 199; and see 28 HALSBURY, LAWS OF ENGLAND, "Trusts and Trustees," §§ 193–97. *Cf.* Bank *v.* Byrnes, 61 Kan. 459, 59 Pac. 1056 (1900).

had known of the trustee's dishonest design, he would have been liable.[33]

In the United States it has been held that where the name of the holder of shares of stock or other corporate securities as registered on the books of the corporation, is followed by the word "trustee" or other words indicating a fiduciary character, and the holder transfers the securities in breach of trust, the corporation is liable for participation in the breach of trust if it registers the transfer without making inquiry as to the extent of the powers of the trustee, if such inquiry would have disclosed the breach of trust.[34] The effect of this doctrine, which has never prevailed in England,[35]

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[33] See Lee *v.* Sankey, L. R. 15 Eq. 204 (1872). *Cf.* Safe Deposit Co. *v.* Cahn, 102 Md. 530, 62 Atl. 819 (1906) (stockbrokers).

In Hoyt *v.* Dollar Savings Bank, 187 App. Div. 243, 175 N. Y. Supp. 377 (1919), it was held that where a bank lent $17,000 and a guardian lent $3,000 to the same person, under an agreement that the whole debt of $20,000 was to be secured by a bond and mortgage to be held by the bank, and that the bank was to have priority in the security, the bank was not liable to the ward, although the loan by the guardian under such an agreement was in breach of trust.

In Isham *v.* Post, 71 Hun 184, 23 N. Y. Supp. 211, 1168 (1893), it was said that when a trustee sends a check to a banker signed by the sender as trustee, with instructions to lend the proceeds upon securities sufficient to assure its repayment, the banker need not inquire into the terms of the trust, and is not put on notice that the trust is of such a character that the investment should be limited to "legal investments." See also Titcomb *v.* Richter, 89 Conn. 226, 93 Atl. 526 (1919) (money deposited in name "M, trustee" with broker for speculative purposes; held broker not chargeable with notice of trust). But if a broker receives trust funds for speculation, knowing that the trustee is committing a breach of trust, he is liable. English *v.* McIntyre, 29 App. Div. 439, 51 N. Y. Supp. 697 (1898).

[34] Lowry *v.* Commercial Bank, Taney (U. S.) 310, 335 (1848); Geyser-Marion Gold Min. Co. *v.* Stark, 106 Fed. (C. C. A. 8) 558 (1901); Stewart *v.* Firemen's Ins. Co., 53 Md. 564 (1880); Marbury *v.* Ehlen, 72 Md. 206, 19 Atl. 648 (1890); Baltimore Trust Co. *v.* George's Creek, etc. Co., 119 Md. 21, 85 Atl. 949 (1912); Loring *v.* Salisbury Mills, 125 Mass. 138, 151 (1878) (see Iasigi *v.* Chicago, etc. R. R. Co., 129 Mass. 46 (1880)); Cooper *v.* Ill. Cent. R. R. Co., 38 App. Div. 22, 57 N. Y. Supp. 925 (1899); Baker *v.* Atlantic, etc. R. R. Co., 173 N. C. 365, 92 S. E. 170 (1917) (executor); Bayard *v.* Farmers' and Mechanics' Bank, 52 Pa. 232 (1866); Peck *v.* Providence Gas Co., 17 R. I. 275, 21 Atl. 543 (1892); Chapman *v.* City Council, 28 S. C. 373, 6 S. E. 158 (1887); Caulkins *v.* Gas-Light Co., 85 Tenn. 683, 4 S. W. 287 (1887). See 1 COOK, CORPORATIONS, 7 ed., §§ 327, 330, 399; 1 MACHEN, CORPORATIONS, §§ 985–994; LOWELL, TRANSFER OF STOCK, §§ 149–159; CAMPBELL, LEGAL ASPECTS OF THE TRANSFER OF SECURITIES, 28–44; 14 CORP. JUR. 744; 3 MASS. L. QUART. 284. But see Thompson *v.* Toland, 48 Cal. 99 (1874) ("trustee" not notice of trust).

[35] Hartga *v.* Bank of England, 3 Ves. 55 (1796); Bank of England *v.* Parsons, 5 Ves. 665 (1800). See Franklin *v.* Bank of England, 9 B. & C. 156 (1829). *Cf.* Simpson *v.* Molsons' Bank, [1895] A. C. 270, which construes a provision in a Canadian statute

is to put upon the corporation responsibility for preventing breaches of trust. But it seems absurd to compel the transfer agent of a corporation to determine the different questions which may arise as to the powers of a trustee. The effect is seriously to obstruct the administration of trusts and to increase the expenses of administration. As Lord Loughborough said in *Hartga* v. *Bank of England*,[36] in speaking of the responsibility that such a rule would throw upon the Bank of England in registering transfers of shares in the public funds:

"The consequence would be exceedingly alarming, if in all cases, where there is a legacy in trust, the Bank is to take notice of the execution of the trust. The consequence would be that for every legacy in trust of stock there must be a bill in Chancery." [37]

The rule has recently been changed in Massachusetts by statute.[38] Where the rule prevails it is not uncommon for a trustee to avoid its application by registering the stock in his own name

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incorporating the defendant bank that "The bank shall not be bound to see to the execution of any trust whether express, implied or constructive to which any of the shares of the bank may be subject," and holds the bank not liable for registering a transfer without actual knowledge of a breach of trust.

The Companies (Consolidation) Act, 1908 (8 Ed. VII, c. 69) § 27, provides: "No notice of any trust, expressed, implied, or constructive, shall be entered on the register, or be receivable by the registrar, in the case of companies registered in England or Ireland." See PALMER'S COMPANY LAW, 10 ed., c. XIV.

[36] 3 Ves. 55, 58 (1796).

[37] In *Re* Perkins, 24 Q. B. D. 613, 616 (1890), Lord Coleridge, C. J., said: "It seems to me extremely important not to throw any doubt on the principle that companies have nothing whatever to do with the relations between trustees and their *cestuis que trust* in respect of the shares of the company. If a trustee is on the company's register as the holder of shares, the relations which he may have with some other person in respect of the shares are matters with which the company have nothing whatever to do; they can look only to the man whose name is upon the register. It seems to me that, if we were to throw any doubt upon that rule, we should make the carrying on of their business by joint stock companies extremely difficult, and might involve those companies in very serious questions, and the ultimate result would be anything but beneficial to the holders of shares in such companies themselves."

[38] MASS. L. 1918, c. 68, § 3. This statute provides: "A company or corporation, public or private, or quasi corporation, or the managers of any trust shall not be bound to see to the execution of any trust, express, implied, or constructive, to which any of its shares, bonds, or securities are subject, or to ascertain or inquire whether the trust authorizes a transfer thereof by the holder, but the provisions of this section shall not be a protection against liability for knowingly participating in a breach of trust." See 3 MASS. L. QUART. 70, 284. See also RUSSELL, STATS. KY. (1909), § 4169; DEL. REV. CODE (1915), § 3396; 4 PURDON'S DIG. PA., 13 ed., 4850, § 7.

individually, keeping the trust off the register — an undesirable practice. It is a not uncommon practice to insert in a trust instrument a provision that no corporation shall be affected by notice that its shares, bonds, or other securities are subject to the trust or shall be bound to see to the execution of the trust or to ascertain or inquire whether any transfer thereof is authorized.

What are the liabilities of depositories of trust funds? In the course of the administration of a trust, it frequently happens that a certain amount of cash comes into the hands of the trustee. It is natural and proper that for safekeeping he should deposit the cash in a bank.[39] As a rule, the trust funds should be deposited in an account separate from that in which the trustee keeps his own funds, and the form of the deposit should be such as to indicate its fiduciary character; and according to the weight of authority if the bank becomes insolvent the trustee is personally liable if the trust fund was blended with the trustee's individual account;[40] and even if there was no such blending he is liable if the deposit does not on its face indicate its fiduciary character.[41] But there is some authority the other way.[42] At any rate the question of the liability of the depository bank is quite different from that of the liability of the depositor.

If a trustee in the proper performance of his duty makes a deposit in a bank in a trust account, the bank does not become a trustee of the money,[43] unless indeed it agrees with the trustee to

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39 SCOTT, CASES ON TRUSTS, 784.

40 AMES, CASES ON TRUSTS, 484 n.

41 Chancellor *v.* Chancellor, 177 Ala. 44, 58 So. 423 (1912) (administrator); *Re* Arguello, 97 Cal. 196, 31 Pac. 937 (1893) (administrator); McAllister *v.* Comm., 30 Pa. 536 (1858) (trustee); Booth *v.* Wilkinson, 78 Wis. 652, 47 N. W. 1128 (1891) (guardian). See AMES, CASES ON TRUSTS, 484 n; SCOTT, CASES ON TRUSTS, 787 n; Ann. Cas. 1915 C, 54.

42 United States, etc. Co. *v.* First Nat. Bank, 18 Cal. App. 437, 123 Pac. 352 (1912) (guardian); Goodwin *v.* American Nat. Bank, 48 Conn. 550 (1881) (executor); Bischoff *v.* Yorkville Bank, 218 N. Y. 106, 112 N. E. 759 (1916) (executor); Sagone *v.* Mackey, 225 N. Y. 594, 122 N. E. 621 (1919) (agent). But see N. Y. Surrogate Court Act, Laws 1920, c. 928, § 231, making it a misdemeanor for an executor, administrator, guardian or testamentary trustee to deposit funds of the estate in his own name.

43 Fletcher *v.* Sharpe, 108 Ind. 276, 9 N. E. 142 (1886) (administrator); Officer *v.* Officer, 120 Ia. 389, 94 N. W. 947 (1903) (executor); Brown *v.* Sheldon State Bank, 139 Ia. 83, 91, 117 N. W. 289 (1908) (public officer); Phillips *v.* Bank, 98 Kan. 383, 158 Pac. 23 (1916) (public officer); Paul *v.* Draper, 158 Mo. 197, 59 S. W. 77 (1909)

keep the money separate and distinct from the other funds of the bank. A general deposit, though it be a deposit of trust funds placed to the credit of the depositor "as trustee," creates the relationship of debtor and creditor between the depository bank and the depositor. The trustee becomes a creditor of the bank, and holds his claim against the bank in trust for the beneficiary.

If the trustee in fact has no authority to make the deposit in the bank and if the bank actually knows of the absence of authority, then indeed the bank is chargeable with participation in the breach of trust, and may be held as constructive trustee of the money.[44] But has a bank any duty to inquire as to the trustee's authority to make the deposit? The depositor may of course be acting improperly in making the deposit; on the other hand it is possible that he is acting properly. It would impose too severe a burden on the bank if it were bound to investigate the conduct of the depositor and to determine whether his conduct is proper or not. It might indeed make inquiry of the depositor, but such an inquiry would naturally be regarded by a depositor as officious and insulting, and in most cases if the depositor were in fact acting wrongfully, his answers would be false and of no avail in preventing a breach of trust.[45] And as a practical business matter it is impossible for

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(guardian); City of Sturgis *v.* Meade Co. Bank, 38 S. D. 317, 161 N. W. 327 (1917) (public officer). See PERRY, TRUSTS, 6 ed., § 122; 7 CORP. JUR. 633; 5 L. R. A. (N. S.) 888; 16 L. R. A. (N. S.) 918; L. R. A. 1917 A, 683; 8 Ann. Cas. 116; 3 R. C. L. 644.

[44] Board of Com'rs *v.* Strawn, 157 Fed. (C. C. A. 6) 49 (1907) (public officer); State *v.* Bruce, 17 Ida. 1, 102 Pac. 831 (1909) (public officer); Tesene *v.* Iowa State Bank, 173 N. W. (Iowa) 918 (1919) (guardian); City of Lincoln *v.* Morrison, 64 Neb. 822, 90 N. W. 905 (1902) (public officer); Watts *v.* Board of Com'rs, 21 Okl. 231, 95 Pac. 771 (1908) (public officer). *Cf.* Franklin Sav. Bank *v.* International Trust Co., 215 Mass. 231, 102 N. E. 363 (1913) (check illegally indorsed by public officer for circulation). See also Quincy Mut. Fire Ins. Co. *v.* International Trust Co., 217 Mass. 370, 104 N. E. 845 (1914). *Cf.* Ross *v.* London, etc. Bank, [1919] 1 K. B. 678. See 3 R. C. L. 555.

If at the time of the deposit the bank had no notice that the depositor was acting wrongfully in making the deposit, but receives notice before the deposit is withdrawn, it is liable if it allows a withdrawal. Frazier *v.* The Erie Bank, 8 Watts & S. (Pa.) 18 (agent) (1844); Miller *v.* Bank of Washington, 176 N. C. 152, 96 S. E. 977 (1918) (agent or trustee).

[45] Where an inquiry is required, an inquiry of the trustee may be sufficient (Grafflin *v.* Robb, 84 Md. 451, 35 Atl. 971 (1896); Mercantile National Bank *v.* Parsons, 54 Minn. 56, 55 N. W. 825 (1893)); or under some circumstances it may not be sufficient.

banks to make any real investigation of the circumstances before deposits are received. In a case decided by the Supreme Court of New Hampshire, it was said:

"To charge banks with the duty of supervising the administration of trusts, when in the due course of business they receive checks and drafts payable to and properly indorsed by trustees in their trust capacity, would place an unreasonable burden upon the banks and seriously interfere with commercial transactions." [46]

Accordingly by the weight of authority a bank is not liable for participation in a breach of trust merely because it receives funds which it knows to be fiduciary funds and credits them to the private account of the depositor, in accordance with his directions.[47] Thus if a trustee or other fiduciary indorses a check payable to him as trustee and deposits the same to the credit of his individual account, the bank is under no duty to make inquiry as to the propriety of the depositor's conduct.[48] So too if a trustee

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Chicago Title & T. Co. *v.* Brugger, 196 Ill. 96, 63 N. E. 637 (1902). See LOWELL, TRANSFER OF STOCK, § 72.

In Wilson *v.* Metropolitan El. Ry. Co., 120 N. Y. 145, 24 N. E. 384 (1890), it was held that if an inquiry by a purchaser would have shown apparent authority in the transferor, the purchaser is protected although he made no inquiry and the transferor in fact was committing a breach of trust. *Cf.* Buckley *v.* Hansfield, 72 Misc. 218, 131 N. Y. Supp. 105 (1911); Hanover Nat. Bank *v.* American Dock Co., 75 Hun 55, 26 N. Y. Supp. 1055 (1894); Fensterer *v.* Pressure Lighting Co., 85 Misc. 621, 149 N. Y. Supp. 49 (1914); Ward *v.* City Trust Co., 192 N. Y. 61, 84 N. E. 585 (1908). In Jones *v.* Williams, 24 Beav. 47 (1857), however, it was held that where the purchaser is put on inquiry but makes no inquiry, he is not protected although a false answer to his inquiry by the transferor might have been made and if made would have dispensed with further inquiry. See Allen *v.* Puritan Trust Co., 211 Mass. 409, 421, 97 N. E. 916 (1912).

[46] Brookhouse *v.* Union Publishing Co., 73 N. H. 368, 370, 373, 62 Atl. 219 (1905), per Chase, J.

[47] In general a bank may be liable when it disobeys instructions either in receiving deposits, as where a check sent for trust account is credited to depositor's private account (Blanton *v.* First Nat. Bank, 136 Ark. 441, 206 S. W. 745 (1918); Duckett *v.* Mechanics' Bank, 86 Md. 400, 38 Atl. 983 (1897); but see Coleman *v.* Bucks, etc. Bank, [1897] 2 Ch. 243); or in honoring checks. American Nat. Bank *v.* Fidelity & D. Co., 129 Ga. 126, 58 S. E. 867 (1907) (check of receiver paid without order of court); U. S. Fidelity & G. Co. *v.* U. S. Nat. Bank, 80 Ore. 361, 157 Pac. 155 (1916) (individual check paid out of deposit as guardian). See British America Elevator Co. *v.* Bank of British North America, [1919] A. C. 658; Cushman *v.* Ill. Starch Co., 79 Ill. 281 (1875); Neiman *v.* Beacon Trust Co., 170 Mass. 452, 49 N. E. 748 (1898). See L. R. A. 1915 C, 522.

[48] Coleman *v.* Bucks, etc. Bank, [1897] 2 Ch. 243 (trustee); Shields *v.* Bank of Ire-

draws a check upon an account in another bank standing in his name as trustee, and deposits the same to his individual credit with the defendant bank, the latter bank is not bound to inquire as to the propriety of the trustee's conduct.[49]

If a bank should not be liable for receiving deposits when it has no knowledge of the misconduct of the depositor in making the deposits, *a fortiori* it should not be liable for allowing withdrawals if it has no knowledge of the misconduct of the depositor in making the withdrawals.[50] For although a bank is not bound to accept deposits, it is under an obligation to honor its depositor's checks,

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land, [1901] 1 I. R. 222 (executor); Santa Marina Co. *v.* Canadian Bank, 254 Fed. (C. C. A. 9) 391 (1918), *certiorari* denied, 39 Sup. Ct. Rep. 493 (1919) (corporate officer); United States, etc. Co. *v.* First Nat. Bank, 18 Cal. App. 437, 123 Pac. 352 (1912) (guardian); Miami County Bank *v.* State, 61 Ind. App. 360, 112 N. E. 40 (1916) (administrator, *semble*); Duckett *v.* Mechanics' Bank, 86 Md. 400, 38 Atl. 983 (1897) (trustee); Batchelder *v.* Central Nat. Bank, 188 Mass. 25, 73 N. E. 1024 (1905) (trustee); Brookhouse *v.* Union Publishing Co., 73 N. H. 368, 62 Atl. 219 (1905) (guardian); Gate City B. & L. Ass. *v.* Bank, 126 Mo. 82, 28 S. W. 633 (1894) (corporate officer); Bischoff *v.* Yorkville Bank, 218 N. Y. 106, 112 N. E. 759 (1916) (executor); Mills *v.* Nassau Bank, 52 Misc. 243, 102 N. Y. Supp. 1119 (1906) (agent); Safe Deposit & Trust Co. *v.* Bank, 194 Pa. 334, 44 Atl. 1064 (1909) (administrator); Life Ins. Co. *v.* Amer. Nat. Bank, 6 VA. L. REG., (N. S.) 106 (1919) (corporate officer); Mott Iron Works *v.* Bank, 78 Wash. 294, 139 Pac. 36 (1914) (agent); United States Fidelity & G. Co. *v.* Bank, 77 W. Va. 665, 88 S. E. 109 (1916) (administrator). *Cf.* Nehawka Bank *v.* Ingersoll, 2 Neb. (Unof.) 617, 89 N. W. 618 (1902) (agent).

But see *contra*, Bank *v.* McPherson, 102 Miss. 852, 59 So. 934 (1912) (public officer); United States Fidelity & G. Co. *v.* Bank, 127 Tenn. 720, 157 S. W. 414 (1913) (guardian).

In a recent New York case where a number of checks payable to the order of a corporation were indorsed by its president, who had authority to indorse checks, and were deposited by him in his individual account in a bank, and subsequently he withdrew the proceeds and misappropriated them, the bank was held liable. Wagner Trading Co. *v.* Battery Park Nat. Bank, 228 N. Y. 37, 126 N. E. 347 (1920). See Niagara Woolen Co. *v.* Pacific Bank, 141 App. Div. 265, 126 N. Y. Supp. 980 (1910). See 37 BANK L. J. 277, 505.

[49] Allen *v.* Puritan Trust Co., 211 Mass. 409, 97 N. E. 916 (1912) (administrator); Allen *v.* Fourth Nat. Bank, 224 Mass. 239, 112 N. E. 650 (1916) (administrator); Kendall *v.* Fidelity Trust Co., 230 Mass. 238, 119 N. E. 861 (1918) (treasurer of business trust); Havana Central R. R. Co. *v.* Knickerbocker Trust Co., 198 N. Y. 422, 92 N. E. 12 (1910) (corporate officer).

It is immaterial whether the check is payable to the depository bank or to the depositor. Kendall *v.* Fidelity Trust Co., *supra*.

[50] If the bank has actual notice that the trustee is improperly making a withdrawal it is liable. Lowndes *v.* City Nat. Bank, 82 Conn. 8, 72 Atl. 150 (1909); Miami County Bank *v.* State, 61 Ind. App. 360, 112 N. E. 40 (1916); Atwood-Stone Co. *v.* Bank, 38 S. D. 377, 161 N. W. 539 (1917); 12 Ann. Cas. 669; Ann. Cas. 1914 B, 677; 7 CORP. JUR. 645.

and if it refuses without justification to honor his check it renders itself liable to the depositor. The fact that the depositor is a trustee and may possibly be acting wrongfully is not a sufficient justification for a refusal to honor his check. It would be unfair to the bank to put it in a position where it would be compelled to ascertain at its peril whether the depositor is committing a breach of trust. In *Gray* v. *Johnston*,[51] in holding that the defendant bank was not liable for honoring a check drawn upon it by an executrix and payable to and deposited in the same bank to the credit of a firm of which the executrix was a member, Lord Cairns said: —

"On the one hand, it would be a most serious matter if bankers were to be allowed, on light and trifling grounds — on grounds of mere suspicion or curiosity — to refuse to honour a cheque drawn by their customer, even although that customer might happen to be an administrator or an executor. On the other hand, it would be equally of serious moment if bankers were to be allowed to shelter themselves under that title, and to say that they were at liberty to become parties or privies to a breach of trust committed with regard to trust property, and, looking to their position as bankers merely, to insist that they were entitled to pay away money which constituted a part of trust property at a time when they knew it was going to be misapplied, and for the purpose of its being so misapplied. I think, fortunately, your Lordships will find that the law on that point is clearly laid down, and may be derived without any hesitation from the authorities which have been cited in the argument at your Lordships' bar, and I apprehend that you will agree with me when I say that the result of those authorities is clearly this: in order to hold a banker justified in refusing to pay a demand of his customer, the customer being an executor, and drawing a cheque as an executor, there must, in the first place, be some misapplication, some breach of trust, intended by the executor, and there must in the second place, as was said by Sir *John Leach*, in the well known case of *Keane* v. *Robarts* (4 Madd. 357), be proof that the bankers are privy to the intent to make this misapplication of the trust funds. And to that I think I may safely add, that if it be shewn that any personal benefit to the bankers themselves is designed or stipulated for, that circumstance, above all others, will most readily establish the fact that the bankers are in privity with the breach of trust which is about to be committed."

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[51] L. R. 3 H. L. 1, 11 (1868).

Accordingly a drawee bank is not liable merely because it honors a check drawn by a depositor as fiduciary and payable to a third person.[52] Nor is it liable where it honors such a check payable to the depositor personally, either by paying cash over the counter to the depositor, or by paying a subsequent holder, or by paying another bank through which the check is collected for the depositor or for a subsequent holder,[53] or by crediting the depositor's individual account in the drawee bank.[54] And a bank is not liable

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[52] Evans *v.* Evans & Co., 82 Iowa 492, 48 N. W. 929 (1891) (partner); Young *v.* Trust Co., 134 La. 879, 64 So. 806 (1914) (liquidator of corporation); Eyrich *v.* Capital State Bank, 67 Miss. 60, 6 So. 615 (1889) (partner); Federal Heating Co. *v.* Buffalo, 182 App. Div. 128, 170 N. Y. Supp. 515 (1918) (trustee); Interstate Nat. Bank *v.* Claxton, 97 Tex. 569, 80 S. W. 604 (1904) (trustee). See BRADY, BANK CHECKS, 167; 1 MORSE, BANKS AND BANKING, 5 ed., § 317; 3 R. C. L. 549; 7 CORP. JUR. 644; DEC. DIG., BANKS AND BANKING, § 130; 32 BANK. L. J. 397. See MO. REV. STAT., 1909, § 11929. See Newburyport *v.* First Nat. Bank, 216 Mass. 304, 103 N. E. 782 (1914) ("The defendant bank had no pecuniary interest in the payment of the note, and for that reason was not on the same footing as a purchaser of it in the matter of making inquiry").

[53] Havana Central R. R. Co. *v.* Central Trust Co., 204 Fed. (C. C. A. 2) 546 (1913) (corporate officer); Newburyport *v.* Spear, 204 Mass. 146, 90 N. E. 522 (1910) (public officer); State *v.* Chicago, etc. Co., 215 S. W. (Mo.) 20 (1919) (receiver, *semble*); Hood *v.* Kensington Nat. Bank, 230 Pa. 508, 79 Atl. 714 (1911) (guardian).

In Havana Central R. R. Co. *v.* Knickerbocker Trust Co., 198 N. Y. 422, 92 N. E. 12 (1910), the treasurer of a corporation, who was authorized to draw checks on its behalf, drew checks to his own order upon an account of the corporation with the A bank and deposited them to the credit of his private account with the B bank, and after the B bank had collected them, he drew out the proceeds which he used for his own purposes. The court held that the B bank was not liable to the corporation, on the ground that though the B bank was put upon inquiry, it was not bound to look beyond the A bank, because the A bank was the agent of the corporation to determine whether the checks were properly payable. The implication that the A bank was liable was criticized in Havana Central R. R. Co. *v.* Central Trust Co., 204 Fed. (C. C. A. 2) 546 (1913), in which the same transaction was involved and the corporation sued the A bank. The federal court held that the A bank was not the agent of the corporation, but simply its debtor, and that it was not put upon inquiry by the mere fact that the check was payable to the corporate officer who drew it, and consequently was not liable. It is submitted that the decision of the federal court is sound, and that neither bank was chargeable with notice of the treasurer's misconduct. See L. R. A. 1915 B, 715.

[54] Gray *v.* Johnston, L. R. 3 H. L. 1 (1868) (executrix, check credited to firm of which she was member); Goodwin *v.* American Nat. Bank, 48 Conn. 550 (1881) (executor); Allen *v.* Puritan Trust Co., 211 Mass. 409, 97 N. E. 916 (1912) (administrator); Allen *v.* Fourth Nat. Bank, 224 Mass. 239, 112 N. E. 650 (1916) (administrator); Wickenheiser *v.* Colonial Bank, 168 App. Div. 329, 153 N. Y. Supp. 1035 (1915), affirmed 224 N. Y. 651, 121 N. E. 899 (1918) (executor); Taylor *v.* Astor Nat. Bank, 105 Misc. 386, 174 N. Y. Supp. 279 (1918) (trustee); Corn Exch. Bank *v.* Manhattan

when after allowing a depositor to deposit fiduciary funds in his individual account, it subsequently honors his personal checks drawn on that account.[55] The bank is not bound in any of these cases to inquire into the use the fiduciary depositor is making or intends to make of the proceeds of the checks.

Certain risks of course a bank must run even though it acts in good faith and is not in any way negligent. If a bank honors a forged check or a check with a forged indorsement, it is liable to the depositor.[56] It has not discharged its indebtedness to the depositor, for it has paid a person not authorized by him to receive payment. Similarly a bank is liable when it pays one who falsely represents himself to be the payee of a check,[57] or when the amount of the check has been raised,[58] unless indeed the depositor by his

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Sav. Inst., 105 Misc. 615, 173 N. Y. Supp. 799 (1919), affirmed 188 App. Div. 922, 176 N. Y. Supp. 894 (1919) (trustee); Town of Eastchester *v.* Mt. Vernon T. Co., 173 App. Div. 482, 139 N. Y. Supp. 289 (1916) (public officer); Interstate Nat. Bank *v.* Claxton, 97 Tex. 569, 80 S. W. 604 (1904) (agent); Clench *v.* Consolidated Bank, 31 U. C. C. P. 169 (1880) (assignee). But see *contra*, American Bonding Co. *v.* Bank, 97 Md. 598, 55 Atl. 395 (1903) (public officer, interest credited to private account).

[55] See notes 48 and 49, *supra*.

The Georgia Banking Act, Art. 19, § 42 (GA. LAWS, 1919, 209) provides: "Whenever any agent, administrator, executor, guardian, trustee, either express or implied, or other fiduciary whether *bona fide* or *mala fide*, shall deposit any money in any bank to his credit as an individual, or as such agent, trustee, or other fiduciary, whether the name of the person or corporation for whom he is acting or purporting to act be given or not, such bank shall be authorized to pay the amount of such deposit or any part thereof, upon the check of such agent, administrator, executor, guardian, trustee, or other fiduciary, signed with the name in which such deposit was entered, without being accountable in any way to the principal, *cestui que trust*, or other person or corporation who may be entitled to or interested in the amount so deposited.

"Nothing herein contained shall prevent the person or corporation claiming the beneficial interest in or to any deposit in any bank from resorting to the courts to subject such deposit, provided such action is brought and served before such deposit is paid out, and to any action brought for this purpose both the bank and the depositor shall be necessary parties defendant." See MO. REV. STAT., 1909, § 11929; STATUTES OF CANADA, 3 & 4 Geo. V, c. 9, § 96 (1913).

There are statutes in many states providing that when a deposit is made by one person in trust for another, and no other notice of its existence and terms is given to the bank, the bank may pay the latter on the death of the former. New York Banking Law, §§ 148, 198, 249; BRADY, BANK DEPOSITS, App. B. Similarly, there are statutes governing joint deposits, *ibid.*; and deposits made by minors or married women.

[56] Szwento Juozupo Let Draugystes *v.* Manh. Sav. Inst., 178 App. Div. 57, 164 N. Y. Supp. 498 (1917); 7 CORP. JUR. 683, 686.

[57] 7 CORP. JUR. 677.

[58] 7 CORP. JUR. 684.

negligence made possible the alteration.[59] So also a bank is liable when it holds on deposit funds of a corporation and honors a check drawn upon it in the name of the corporation by an officer who was not empowered to draw checks,[60] or when it honors a check payable to a corporation and indorsed by an officer who had no power to indorse on behalf of the corporation.[61] So also a bank is liable when it honors a check drawn upon his principal's account by an agent acting outside the scope of his employment,[62] or a check payable to the principal and indorsed by an agent not empowered to indorse.[63] A distinction must be made between want of power and abuse of authority. If the corporate officer or the agent was empowered to draw or indorse checks on behalf of the corporation or principal, the bank will not be liable although the officer or agent was abusing his authority in drawing or indorsing checks, unless it knew or ought to have known of the abuse of authority. Similarly in the case of trusts if there are several trustees and the bank honors a check drawn or indorsed by only a part of the trustees it will be liable, since one trustee has no power to bind his co-trustees,[64] although it will not be liable if all the trustees sign or indorse a check unless it knows or ought to know that they are in fact acting wrongfully.

If the bank is a creditor of the depositor individually, as in the case where he is liable on a note held by the bank or where he has overdrawn his individual account with the bank, it cannot set off

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[59] 7 CORP. JUR. 684.

[60] 2 DANIEL, NEGOTIABLE INSTRUMENTS, 6 ed., § 1616; 7 CORP. JUR. 676. See Havana Cent. R. Co. *v.* Central Trust Co., 204 Fed. (C. C. A. 2) 546, 550 (1913).

[61] Buena Vista Oil Co. *v.* Park Bank, 39 Cal. App. 710, 180 Pac. 12 (1919); Walker *v.* State Trust Co., 40 App. Div. 55, 57 N. Y. Supp. 525 (1899); Moch Co. *v.* Security Bank, 176 App. Div. 842, 163 N. Y. Supp. 277 (1917), affirmed 225 N. Y. 723, 122 N. E. 879 (1919).

[62] Merchants' Nat. Bank *v.* Nichols & Co., 223 Ill. 41, 79 N. E. 38 (1906). See Sims *v.* United States Trust Co., 103 N. Y. 472, 9 N. E. 605 (1886); 1 MORSE, BANKS AND BANKING, 5 ed., § 314. But if the account is in the name of the depositor as agent, the bank may safely honor checks drawn by him as agent. Pennsylvania T. & T. Co. *v.* Meyer, 201 Pa. 299, 50 Atl. 998 (1902). *Cf.* Holden *v.* Bank, 77 N. H. 535 (deposit by executor who had not qualified). See Tassel *v.* Cooper, 9 C. B. 509 (1850).

[63] Schaap *v.* State Bank, 137 Ark. 251, 208 S. W. 309 (1918); Hope, etc. Co. *v.* Bank, 101 Kan. 726, 168 Pac. 870 (1917); Robinson *v.* Chemical Nat. Bank, 86 N. Y. 404 (1881).

[64] Barroll *v.* Forman, 88 Md. 188, 40 Atl. 883 (1898). *Cf.* Lee *v.* Sankey, L. R. 15 Eq. 204 (1872) (payment by solicitor to one of two trustees). See 2 DANIEL, NEGOTIABLE INSTRUMENTS, 6 ed., § 1615; 7 CORP. JUR. 677.

a deposit standing in his name as trustee or otherwise in such form as to indicate the fiduciary character of the deposit.[65] In the United States it is held that it is not proper for the bank to accept in payment of an individual indebtedness of the depositor a check payable to the depositor as fiduciary and indorsed by him, or a check drawn by him upon his account as fiduciary in the same bank or in another bank.[66] It is held that the bank has notice under such circumstances that the payment is presumptively wrongful. The same result has been reached where a deposit of fiduciary funds is made in the fiduciary's personal account, and the depositor subsequently pays a personal debt to the bank by a check drawn on that account; for it is held that although the bank is not chargeable with notice that the deposit is in breach of trust, it is chargeable with notice that a trust attaches to the personal account to the extent of the fiduciary funds therein deposited; and the bank is liable to the extent that such funds are withdrawn in paying the depositor's debt to the bank.[67] The effect of these

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[65] *Ex parte* Kingston, L. R. 6 Ch. 632 (1871) (public officer); National Bank *v.* Insurance Co., 104 U. S. 54 (1881) (agent); Keeney *v.* Bank of Italy, 33 Cal. App. 515, 165 Pac. 735 (1917) (trustee); First Nat. Bank *v.* Banking Co., 108 Me. 79, 79 Atl. 4 (1911) (agent); Edwards *v.* MacArtney, 183 N. Y. Supp. 851 (1920) (trustee). See 1 MORSE, BANKS AND BANKING, 5 ed., § 326; 7 CORP. JUR. 658, 660; DEC. DIG., BANKS AND BANKING, § 134(7). See note 11, *supra*.

[66] Union Stock Yards Bank *v.* Gillespie, 137 U. S. 411 (1890) (factor); United States Fidelity & G. Co. *v.* Union Bank, 228 Fed. (C. C. A. 6) 448 (1913) (public officer); Washbon *v.* Bank, 87 Kan. 698, 125 Pac. 17 (1912) (treasurer of fraternal organization); Allen *v.* Puritan Trust Co., 211 Mass. 409, 97 N. E. 916 (1912) (administrator); State Bank of St. Johns *v.* McCabe, 135 Mich. 479, 98 N. W. 20 (1904) (trustee); Hale *v.* Windsor Sav. Bank, 90 Vt. 487, 98 Atl. 993 (1916) (executor); Ward *v.* City Trust Co., 192 N. Y. 61, 84 N. E. 585 (1908) (corporate officer); Bischoff *v.* Yorkville Bank, 218 N. Y. 106, 112 N. E. 759 (1916) (executor); Fidelity & D. Co. *v.* Rankin, 33 Okl. 7, 124 Pac. 71 (1912) (public officer); Brovan *v.* Kyle, 166 Wis. 347, 165 N. W. 382 (1917) (guardian). See 1 MORSE, BANKS AND BANKING, 5 ed., § 317; DEC. DIG., BANKS AND BANKING, § 130.

As to the validity of loans on the security of savings bank trust deposits, in view of the decision in *Re* Totten, 179 N. Y. 112, 71 N. E. 748 (1904), see Corn Exch. Bank *v.* Manhattan Sav. Inst., 105 Misc. 615, 173 N. Y. Supp. 799 (1919); 37 BANK. L. J. 753.

[67] United States Fidelity & G. Co. *v.* Union Bank, 228 Fed. (C. C. A. 6) 448 (1913) (public officer); First Nat. Bank *v.* Greene, 114 S. W. (Ky.) 322 (1908) (guardian); Allen *v.* Puritan Trust Co., 211 Mass. 409, 97 N. E. 916 (1912) (administrator); Bischoff *v.* Yorkville Bank, 218 N. Y. 106, 112 N. E. 759 (1916) (executor). But see United States Fidelity & G. Co. *v.* Bank, 77 W. Va. 665, 670, 88 S. E. 109 (1918) ("For aught a bank would know a check though payable to its depositor in some

decisions is to put upon the bank the burden of ascertaining how far the account is made up of fiduciary funds deposited therein and not subsequently withdrawn. In England however the courts have taken a somewhat different view in these cases. Even though a depositor in a bank who has overdrawn his private account deposits in that account a check drawn by him as fiduciary the bank is not necessarily liable; the bank, if it has no actual knowledge that the depositor is committing a breach of trust, is liable only if a personal benefit to the bank "is designed or stipulated for," as Lord Cairns said in *Gray* v. *Johnston*. The benefit to the bank is merely a circumstance tending to prove that the bank knew of or was "privy to" the breach of trust, that is to say, was guilty of bad faith. When therefore an overdraft is amply secured and the bank is not pressing for payment, it is not held to participate in the breach of trust, merely because it receives payment by a check drawn or indorsed by the depositor as fiduciary.[68]

In certain cases, particularly in New York, the courts have gone very far in holding a depository bank chargeable with constructive notice of the depositor's misconduct.

In *Wagner Trading Company* v. *Battery Park National Bank*,[69]

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representative or fiduciary character, the money would belong absolutely to him, and represent money already paid out by him in discharge of his fiduciary liability"). *Cf.* Bank of New South Wales *v.* Goulburn, etc. Co., [1902] A. C. 543 (corporate officer).

[68] See Gray *v.* Johnston, L. R. 3 H. L. 1 (1868) (executor); London Joint Stock Bank *v.* Simmons, [1892] A. C. 201 (stockbroker); Thomson *v.* Clydesdale Bank, [1893] A. C. 282 (stockbroker); Bank of New South Wales *v.* Goulburn, etc. Co., [1902] A. C. 543 (corporate officer); Backhouse *v.* Charlton, 8 Ch. D. 444 (1878) (partner); Marten *v.* Rocke, Eyton & Co., 53 L. T. (N. S.) 946 (1885) (auctioneer); Greenwood Teale *v.* Brown & Co., 11 T. L. R. 56 (1894) (solicitor); Coleman *v.* Bucks & Oxon Union Bank, [1897] 2 Ch. 243 (trustee); Shields *v.* Bank of Ireland, [1901] 1 I. R. 222 (executor).

The bank was held liable on the ground that it was privy to the breach of trust in British America Elevator Co. *v.* Bank, [1919] A. C. 658 (agent); Pannell *v.* Hurley, 2 Coll. C. C. 241 (1845) (trustee); Bodenham *v.* Hoskyns, 2 DeG. M. & G. 903 (agent); *Ex parte* Adair, 24 L. T. (N. S.) 198 (1871) (public officer); Foxton *v.* Manchester, etc. Banking Co., 44 L. T. (N. S.) 406 (1881) (trustee); *Re* Wall, 1 T. L. R. 522 (1885) (trustee).

[69] 228 N. Y. 37, 126 N. E. 347 (1920). See Niagara Woolen Co. *v.* Pacific Bank, 141 App. Div. 265, 126 N. Y. Supp. 980 (1910). See note 48, *supra*. *Cf.* Havana Central R. R. Co. *v.* Knickerbocker Trust Co., 198 N. Y. 422, 92 N. E. 12 (1910), note 53, *supra*. It is uncertain to what classes of fiduciaries the holding of the principal case extends. The opposite result was reached in the case of executors. See Bischoff *v.* Yorkville Bank, hereinafter discussed. But query under the statute

it appeared that a number of checks payable to the order of a corporation were indorsed by its president, who had authority to indorse checks on its behalf, and were deposited by him in his individual account in the defendant bank. Subsequently he withdrew and misappropriated the proceeds of the checks. The bank was held liable, because "the nature of this transaction was such as to warn defendant that the checks were being diverted from usual business channels."

In *Bischoff* v. *Yorkville Bank*,[70] one Poggenburg, an executor, deposited money of the estate in the Bowery Bank in New York in the name of "Estate of Josephine F. Schneider by H. F. W. Poggenburg, executor." He, as an individual, had at that time a deposit account with the defendant Yorkville Bank. From time to time he drew checks upon the Bowery Bank signed by him as executor and payable to the defendant bank, and sent these checks to the defendant bank, the proceeds to be placed to the credit of his individual account with that bank. Additional sums from sources other than the estate were deposited by Poggenburg with the defendant bank from time to time. An individual note of Poggenburg held by the defendant bank was paid by him by a check upon his individual account with that bank in which the amount standing to his credit at that time was less than the proceeds of the checks drawn upon his account as executor in the Bowery Bank. Other individual notes of Poggenburg held by the defendant bank maturing from time to time were paid by him from his individual account with that bank. Eventually Poggenburg withdrew all the funds deposited to his credit with the defendant bank (except a small balance) and used the proceeds for his private purposes. The defendant at no time made any inquiry as to the source of the deposits or the purpose of the withdrawals. The Supreme Court held that the defendant bank was liable to the estate for the proceeds of all the checks drawn by Poggenburg as executor and deposited with the defendant bank and subsequently withdrawn by him. The Appellate Division affirmed the decision of the Supreme Court, but one of the Justices, dissenting, declared

making it a misdemeanor for executors to make deposits of funds of the estate in his own name. See note 42, *supra*. Query also as to trustees. See 37 BANK. L. J. 505.

[70] 218 N. Y. 106, 112 N. E. 759 (1916). See Pratt *v.* Commercial Trust Co., 105 Misc. 324, 174 N. Y. Supp. 88 (1918), affirmed 188 App. Div. 881, 175 N. Y. Supp. 918 (1919).

that the recovery should be limited to the amount paid to the defendant bank on the notes.[71] The Court of Appeals took a third and intermediate view, holding that the defendant bank was liable for the amount of the notes, and also for all amounts withdrawn from the defendant bank by Poggenburg after the time of the payment of the first note, but not for the amounts withdrawn before the payment of that note. The court said:

"In the present case Poggenburg paid to the defendant, as his creditor, on June 3, 1908, the sum of $765 from his account with the defendant. The finding of the trial court, supported by the evidence, is that the account at that time was constituted wholly from the trust funds. At that time and through the transaction the defendant knew that Poggenburg had appropriated $765 of those funds for his private benefit. The presumption that he would not thus violate his duty and lawful right — that he would apply the moneys to their proper purposes under the will then ceased to exist. There was absolute proof in the possession of the defendant to the contrary. The defendant had no longer the right to assume that in paying the checks of Poggenburg it was paying the executor's moneys to the executor and not to Poggenburg, the individual, or that Poggenburg would use the moneys lawfully. It had knowledge of such facts as would reasonably cause it to think and believe that Poggenburg was using the moneys of the executor for his individual advantage and purposes. Those facts indicated that the payment to it was not an isolated incident; they indicated, rather, that it was within a method or system. Having such knowledge, it was under the duty to make reasonable inquiry and endeavor to prevent a diversion. Having such knowledge, it was charged by the law to take the reasonable steps or action essential to keep it from paying to Poggenburg as his own the moneys which were not his and were the executor's, and was bound by the information which it could have obtained if an inquiry on its part had been pushed until the truth had been ascertained. It did nothing of that sort, and by supinely paying, under the facts here, as found, the subsequent checks of Poggenburg, it became privy to the misapplication. It must now pay the plaintiffs the moneys of the estate which it had and received on and after June 3, 1908."

The holding that the defendant bank was not liable for the amounts withdrawn by Poggenburg before payment of the first note, is, as has been shown,[72] in accord with the great weight of

[71] 170 App. Div. 679, 156 N. Y. Supp. 563 (1915).

[72] See note 49, *supra*.

authority. The holding that the defendant bank was liable for the amounts paid to it in discharging Poggenburg's individual indebtedness to it on the notes, is, as has been shown,[73] in accord with the authorities, although of questionable soundness. But the decision so far as it held the defendant bank liable for the amounts withdrawn by Poggenburg after the payment of the first note and not used in paying other notes held by the defendant, goes much further than any prior decisions. In a similar case in Massachusetts, *Allen* v. *Puritan Trust Company*,[74] it was held that the bank's liability was limited to the amount of the checks used in discharging the depositor's individual indebtedness to the bank.[75] It is submitted that the Massachusetts decision is preferable to the New York decision. To hold that a bank as a creditor must not accept payment from its debtor out of funds which it knows were received by the debtor as a fiduciary without inquiring whether such funds had ceased to be fiduciary funds may be proper. But to hold that a bank as depository is chargeable with notice of all facts which such inquiry would elicit, and is liable for all subsequent misappropriations by the fiduciary, would seem to extend the doctrine of constructive notice too far and impose a burdensome responsibility upon the bank.[76]

In *Fidelity and Deposit Company* v. *Queens County Trust Company*,[77] the New York Court of Appeals again went far in holding a depository bank chargeable with constructive notice. In that case one Peebles, a trustee in bankruptcy of one Bailey, opened an account in the defendant bank in the name of "Robert J. Peebles, Trustee," and deposited therein funds of the estate. He made withdrawals from time to time by checks, some of which were countersigned by the clerk of the Federal District Court and con-

[73] See note 67, *supra*.

[74] 211 Mass. 409, 97 N. E. 916 (1912). See L. R. A. 1915 C, 518.

[75] It is to be noticed that although the checks were for a greater sum than the amount of the overdrafts, the bank was held liable for the full amount of the checks used in paying the overdrafts, and not merely for the amount of the overdrafts.

[76] "And farther than that, I take leave to doubt very much whether the mere fact that some breach of trust . . . had in time past been committed by their customer would, alone, have entitled the bankers, or justified them, in refusing to honour the cheque of their customer, unless it could be shewn that they knew, as regards that particular cheque, that it also was to go in the same line of misapplication." Gray *v.* Johnston, L. R. 3 H. L. 1, 12, 13 (1868), per Cairns, L. C.

[77] 226 N. Y. 225, 123 N. E. 864 (1919).

tained in the margin the words "*In re* Wm. Trist Bailey"; others were not so countersigned or marked. Most of the latter checks were deposited to the individual credit of Peebles with the defendant, and the proceeds were subsequently drawn out and used by Peebles for his own purposes. A general order in bankruptcy of the United States Supreme Court provides that no moneys of a bankrupt estate shall be drawn from a depository unless by check countersigned by a judge or referee or clerk of the court; and that a copy of the general order shall be furnished to the depository, and also the name of any referee or clerk authorized to countersign such check. No copy of the order or name of any referee or clerk authorized to countersign checks was furnished to the defendant, and it had no actual notice that the depositor was a trustee in bankruptcy. The court reached the conclusion, "with hesitation however," that the defendant was liable. The court was of the opinion that the bank was chargeable with notice of the bankruptcy of Bailey, for the adjudication was a judgment *in rem;* that it was chargeable with notice of the Bankruptcy Act and of the general order; that it was chargeable with notice that the deposit was of funds of the bankrupt estate, since some of the checks were countersigned by a clerk of the court and contained the words "*In re* Wm. Trist Bailey." [78] "A simple inquiry, by the bank of the trustee, for the reason of the countersignature, would have revealed the existence of the general order and of its provisions." The decision, it is submitted, carries the doctrine of constructive notice to an unreasonable extent.

It is easy to sit down at leisure after the event and to see how a cautious and inquiring banker might have discovered the depositor's misconduct. It would not require the acumen of a Sherlock Holmes to follow the clues which may have been afforded. But should bankers be turned into detectives in order to prevent depositors from acting in violation of their obligations to third persons? It must be remembered also that frequently all the clues

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[78] If the bank had had actual knowledge of these things of course it would be liable. American Nat. Bank *v.* Fidelity & D. Co., 129 Ga. 126, 58 S. E. 867 (1907).

It is agreed that a depository bank is not chargeable with notice of facts appearing in memoranda written on checks. State Nat. Bank *v.* Dodge, 124 U. S. 333 (1888); State Nat. Bank *v.* Reilly, 124 Ill. 464, 14 N. E. 657 (1888); Duckett *v.* Nat. Mechanics' Bank, 86 Md. 400, 38 Atl. 983 (1897); Eyrich *v.* Capital State Bank, 67 Miss. 60, 6 So. 615 (1889).

are not known to any one employee of the bank, and that the facts known to any one employee are not sufficient to arouse suspicion. It must be remembered that the processes of receiving deposits and paying checks are processes in which many employees of the bank take each his separate part.[79] If no one of the employees has knowledge of any breach of trust the bank should not be held liable merely because it appears that at some stage by piecing together all the facts known to different employees a breach of trust would become more or less apparent. The bank is in no way to blame for receiving deposits or allowing withdrawals merely because all the facts known to several employees would, if known to one employee, have aroused a suspicion of misconduct by the depositor. The bank it is submitted should not be liable unless some officer or employee had actual knowledge of the depositor's misconduct or knowledge of facts so clearly indicating such misconduct as to show that the bank was guilty of bad faith.

A trustee or other fiduciary is placed in a situation where there may be a great temptation to pursue his own interest and lose sight of the interest of those for whom he acts. The rules as to the liability of fiduciaries may well be made strict. But a very different question arises as to the liability of third persons dealing with fiduciaries. If third persons knowingly participate with a fiduciary in a breach of his obligations it is proper to hold them liable. It is quite a different matter however to compel them to supervise the conduct of the fiduciary and to hold them liable for failure to do so. A rule imposing such liability upon them makes it dangerous to deal with a fiduciary and seriously interferes with the proper performance by the fiduciary of his duties. It is right to require that one who knowingly purchases trust property from a trustee or other fiduciary whose conduct is *prima facie* wrongful should make a reasonable inquiry, and to hold that he cannot escape liability unless such inquiry would satisfy a reasonable man that the vendor was not committing a breach of trust. If the vendor's conduct is not such as to excite suspicion, still it is held that the purchaser should make inquiry as to the power of the trustee to sell; and it has been so held, with questionable wisdom perhaps, in the case of negotiable instruments. But the rule that purchasers of

[79] See the Master's Report, pp. 15–20, in the record in Allen *v.* Puritan Trust Co., 211 Mass. 409, 97 N. E. 916 (1912).

trust property are bound to see to the application of the purchase-money imposed too heavy a burden on purchasers and resulted in such an intolerable obstruction to the administration of trusts that statutes have in many jurisdictions abolished the rule. The rule that a corporation whose securities are held in trust is bound to investigate whether a transfer of the securities is in breach of trust, imposes a heavy burden on corporations and results in a serious obstruction to the administration of trusts. Similarly to the extent that depositories of trust funds are held bound to inquire into the trustee's conduct, a heavy burden is imposed upon them and the administration of trusts is seriously obstructed. Corporations whose securities are held in trust, and depositories of trust funds, should not be held liable for participation in a breach of trust in the absence of actual knowledge of the breach of trust or conduct amounting to bad faith. This is the view expressed in the English cases, although departures from it have occasionally occurred. In *Barnes* v. *Addy*,[80] Sir W. M. James, L. J., said:

> "I have long thought, and more than once expressed my opinion from this seat, that this Court has in some cases gone to the very verge of justice in making good to *cestuis que trust* the consequences of the breaches of trust of their trustees at the expense of persons perfectly honest, but who have been, in some more or less degree, injudicious. I do not think it is for the good of *cestuis que trust*, or the good of the world, that those cases should be extended."

Are not these observations of peculiar force in the United States, where courts of equity have gone further than in England in making good to *cestuis que trust* the consequences of the breaches of trust of their trustees, at the expense of third persons, who are honest and not always even injudicious?

Austin Wakeman Scott.

HARVARD LAW SCHOOL.

[80] L. R. 9 Ch. 244, 251, 255, 256 (1874). See note 31, *supra*.